19 T.C. 530 (1952)

A loss incurred from the sale of accounts receivable as part of ending a business is considered a capital loss, subject to the limitations of Section 117(d)(1) of the Internal Revenue Code, rather than an ordinary business expense or loss.

Summary

Rogers Utilities, Inc., sold its business, including accounts receivable, to a competitor at a discount. The company claimed the discount as an ordinary loss. The Commissioner of Internal Revenue determined that the loss was a capital loss subject to limitations. The Tax Court agreed with the Commissioner, holding that the sale of accounts receivable was a sale of capital assets and the loss was subject to the limitations on capital losses under Section 117(d)(1) of the Internal Revenue Code. This decision followed the rationale established in Graham Mill & Elevator Co. v. Thomas.

Facts

Rogers Utilities, Inc. was in the retail sale of household goods and appliances, with most sales on installment credit to low-income customers. In July 1947, Max Torodor, who acquired the company in April 1947, decided to discontinue the business. Rogers sold its inventory, fixtures, and accounts receivable to Peerless Home Supply Co. The accounts receivable, totaling $81,680.85, were sold at a 40% discount, resulting in a $32,672.34 loss. Rogers claimed this loss as an ordinary loss or expense on its income tax return.

Procedural History

The Commissioner of Internal Revenue disallowed the deduction of $32,672.34 as a normal deduction, treating it instead as a capital loss. Because there were no capital gains, a deficiency in income tax was assessed. Rogers Utilities, Inc. contested this determination in the Tax Court. Max and Sarah Torodor initially contested their liability as transferees, but later conceded liability contingent on the deficiency being correct.

Issue(s)

Whether the loss incurred by Rogers Utilities, Inc. from the sale of its accounts receivable should be treated as an ordinary business expense/loss or as a capital loss subject to the limitations of Section 117(d)(1) of the Internal Revenue Code.

Holding

No, because the sale of accounts receivable in the context of discontinuing a business is considered a sale of capital assets, making the resulting loss subject to the limitations on capital losses as dictated by Section 117(d)(1) of the Internal

Revenue Code.

Court's Reasoning

The Tax Court rejected the argument that the discount on the accounts receivable should be treated as an ordinary business expense. The court reasoned that Rogers sold accounts receivable with a face value of $81,680.85 for $49,008.51, resulting in a loss of $32,672.34. Applying the precedent set in *Graham Mill & Elevator Co. v. Thomas*, the court determined that the accounts receivable were capital assets. The court stated that "[t]hey represented the taxpayer's business capital, but were not a part of his stock in trade. When the determination was reached to sell them in the way they were sold, they were severed from all further connection with appellant's business. When the sale was effected, the court did not err in finding capital assets were sold." Because the sale was part of ending the business, it was not a sale in the ordinary course of business. Therefore, the loss was a capital loss, and deductions for capital losses are limited by Section 117(d)(1) of the Code. The court acknowledged the potential hardship on the petitioner but emphasized that the limitations on capital losses are statutory and determined by Congress.

Practical Implications

This case clarifies the treatment of losses from the sale of accounts receivable, especially when a business is being discontinued. It reinforces that such a sale is generally treated as the sale of a capital asset, not as an ordinary business transaction. Legal professionals must consider the context of the sale to determine whether the accounts receivable are considered capital assets. This affects how the loss can be deducted for tax purposes. Later cases would likely distinguish this ruling if the sale of accounts receivable occurred in the regular course of business, rather than as part of a business liquidation.

